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Republican Dodd-Frank Replacement Plan Gets a Workout

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Republicans showed near unanimous enthusiasm for House Financial Services Committee Chairman Jeb Hensarling's proposal to replace key elements of the 2010 Dodd-Frank Act at a Tuesday hearing. But Democrats showed up prepared to fight it, making it clear that supporters will need to prepare for rigorous debate on its boldest provisions.

The hearing was a preview of the kind of relitigation of the Dodd-Frank debate that could start if Republicans maintain control of Congress and can work with a friendly Republican president. In particular, they are taking aim at the law's mechanism to wind down failing banks, which has never been tested with a major bank, and its long list of regulations.

Republicans cast Hensarling's solution, known as the Financial CHOICE Act, as a response to the Dodd-Frank rules they say have led to a spike in compliance costs.

The panel's Democrats, meanwhile, said Republicans had the chance to offer amendments or defeat elements of the law that they didn't like when Congress enacted it six years ago.

Hensarling's proposal would set out the capital requirements for regulatory relief, and take away the Financial Stability Oversight Council's authority to declare systemically important financial institutions. It would also repeal Dodd-Frank's "orderly liquidation authority" process — the mechanism to wind down failing banks — in favor of bankruptcy.

Republicans on the committee used Tuesday's hearing to mount a unified defense of Hensarling's proposal, with no sign that any GOP committee members opposed a single element of the language.

Democrats mirrored that unanimity in opposition. They came to Tuesday's hearing with a noticeable determination to criticize the proposal in depth. Their favored witness, Georgetown University Law Professor Adam Levitin, said he believes the GOP's proposal for a 10 percent "leverage ratio" that would trigger regulatory relief was "plucked out of thin air."

"There is no basis, whatsoever, for the 10 percent leverage ratio number," he said. "It's grossly irresponsible to use as the basis for a regulatory system."

Beyond the arbitrary nature of the ratio itself, Levitin said Hensarling's proposal doesn't have strong liquidity requirements to bolster the health of the highly capitalized banks. The private sector does not have the means to provide immediate funding for a bridge company in the event of a bank bankruptcy. And that could lead to the use of public funds.

"A bridge company might need \$50 or \$100 billion of capital the next day," he said. "Capital markets have never provided a [loan] of more than \$9 billion."

Republicans were mostly quiet on Levitin's critiques about repealing the wind-down mechanism.

In a separate interview, however, Mark Calabria, a Dodd-Frank opponent at the Cato Institute, told Morning Consult that for a systemically important bank, just as many "unknowns" exist under Dodd-Frank's wind-down process, which the Federal Deposit Insurance Corp. administers, as with bankruptcy.

"You have the same problem with the FDIC. None of that stuff goes away regardless of the system," Calabria said. He said he supports having a bankruptcy court administer the dismantling of a systemically important bank instead of the FDIC, in part because he believes a judicial process is less linked to politics.

The committee's Democrats, ranging from liberal members to more moderate Democrats, latched onto Levitin's comments to argue that Hensarling's proposal would cause high levels of instability and risk-taking in the financial markets.

"This is a very dangerous bill and it could very well place our economy in a very dangerous situation," said Rep. David Scott of Georgia, a member of the centrist New Democrat Coalition. He pointed to the leverage ratio relief and the bill's removal of the Volcker rule, which curbs banks' ability to speculate on securities with funds from depositors.

Rep. Bill Huizenga (R-Mich.), the chairman of the Financial Services Subcommittee on Monetary Policy and Trade, told Morning Consult separately that he isn't surprised to hear Democrats publicly stand firm on Dodd-Frank, but he knows that they aren't all happy with the law.

"Everybody will acknowledge that there's issues behind closed doors, and then they get out in front of a mic and it's all about what a great thing [Dodd-Frank] was," Huizenga said, "They don't want to actually do anything to the bill."

Democrats, together with Levitin, dismissed nearly every major element of Hensarling's proposal, but it doesn't appear at this point that Republicans believe their bill needs any major changes.

At the hearing, Huizenga took particular issue with Levitin's claim that the 10 percent capital-to-debt ratio was arbitrary. He noted that, according to FDIC data, 98 percent of banks with a minimum leverage ratio of 10 percent survived the 2008 financial crisis.

Alex Pollock, a distinguished senior fellow at the center-right R Street Institute, bolstered that argument by noting that the International Monetary Fund has estimated that a 9.5 total leverage exposure — an even lower bar — could have prevented creditor losses in the event of a banking crisis.